Regulating Crypto-Currencies, Utility Tokens, and Crypto-Asset Service Providers
EU-Requirements to Address Legal Certainty and Other Risks
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The EU Commission has proposed a comprehensive regulatory framework for crypto-assets. This encompasses a Regulation on Markets in Crypto-Assets (MiCA). This cepInput deals with non-stablecoin crypto-assets and crypto-asset service providers.

Key propositions
► While legal certainty for crypto-assets would be most welcome, the Regulation fails to provide it sufficiently for crypto-assets, which do not have a legal entity as issuer.
► The Commission should consider setting out minimum requirements for the technological skills and tools of national supervisors and should harmonise relevant private law rules to ease cross-border transactions involving crypto-assets.
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1 Introduction

On 24 September 2020, the EU Commission proposed for the first time a regulatory framework for crypto-assets. The proposed framework includes the following:

- a Regulation on Markets in Crypto-Assets (MiCA), setting out a general and harmonised framework for the issuance of crypto-assets and the provision of related services;\(^1\)
- changes to the MiFID (Directive on Financial Instruments)\(^2\), clarifying that MiFID applies to financial instruments based on distributed ledger technologies (DLTs); and
- a Regulation setting out a pilot regime for market infrastructures based on DLTs.\(^3\)

This cepInput focusses on the MiCA Regulation. It starts by providing a short explanation of what crypto-assets are and how they can be used in financial markets (chapter 2). Chapter 3 is a concise overview of the regulatory treatment of crypto-assets under MiCA, whereas stablecoins, which are a subset of crypto-assets are dealt with more thoroughly in another cepInput. Chapter 4 is devoted to assessing the MiCA regime concerning crypto-assets issuers and crypto-assets service providers by focussing on a few specific issues. The conclusions are laid down in chapter 5.

2 Crypto-Assets in Financial Markets

2.1 What Are Crypto-Assets?

Cryptographic assets (crypto-assets) are digital representations of existing assets (i.e. a right) or of a value, which can be stored, transferred or traded electronically through the use of a technology called “Distributed Ledger Technology”. The integrity of such digital assets is ensured through a mathematical procedure called “cryptography”.\(^5\)

The creation of crypto-assets is a form of tokenisation, which is one of the main applications of the DLT technology. Tokenising an asset means turning such asset into an “information unit” called “token”, which is clearly attributed to a person (through an identifier of the latter) and can be securely transferred to other persons (each of which possess a different identifier) through the use of the DLT network.\(^6\)

The DLT technology makes it possible to record and store information (e.g. the transactions involving the asset) within an online register – the distributed ledger –, which is accessible to all network users. As a consequence there is no need for central record keeping. Also, multiple transactions involving

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\(^6\) It should be stressed that tokenisation is an important application of DLT technology, but not the only one. Other applications include smart contracts, ICOs and STOs.
one specific digital asset ("double spending") can be excluded as the nodes of the system, i.e. the parties to the network which validate transactions, would simply refuse validation.\footnote{The explanation of the DLT is based upon Natarajan, Harish; Krause, Solvej; Gradstein, Helen. 2017. Distributed Ledger Technology and Blockchain. FinTech Note; No. 1. World Bank, Washington. However, the authors point out that "DLT is not one single, well-defined technology. Instead, a plurality of blockchains and distributed ledgers are active or are under development today and their designs and precise configurations vary depending on the creators’ goals and the DL’s purpose and developmental stage".}

\section{2.2 Crypto-Assets in Financial Markets}

DLT applications in the financial sector are almost unlimited, given that any asset can be tokenised and most financial activities can be carried out through the use of DLT. Based on their economic function, three categories of crypto-assets can be identified.\footnote{This taxonomy is used in Securities and Markets Stakeholders Group, Own Initiative Report on Initial Coin Offerings and Crypto-assets, 19 October 2018, accessible at \url{https://www.esma.europa.eu/sites/default/files/library/esma22-106-1338_smrg_advice_-_report_on_icos_and_cryptocurrency.pdf}.} \footnote{For a more detailed description and an analysis of cryptocurrencies, see Eckhardt P., Warhem V., The Money of Tomorrow. Cryptocurrencies, stablecoins, central bank digital currencies, cepInput 4/2020, accessible at \url{https://www.cryptowaehrungen.cepInput_The_Money_of_Tomorrow_01.pdf}.}

- **Cryptocurrencies or payment tokens** are a means of payment for acquiring goods or services. The most well-known cryptocurrency is Bitcoin.\footnote{Eckhardt P., Warhem V., The Money of Tomorrow. Cryptocurrencies, stablecoins, central bank digital currencies, cepInput 4/2020, accessible at \url{https://www.cryptowaehrungen.cepInput_The_Money_of_Tomorrow_01.pdf}.} **Stablecoins** are a subset of cryptocurrencies\footnote{ECB Crypto-Assets Task Force, Stablecoins: Implications for monetary policy, financial stability, market infrastructure and payments, and banking supervision in the euro area, Occasional Paper Series, No 247 / September 2020, p. 7.} that rely on a set of stabilisation tools to minimise fluctuations in their price, as measured in real currencies.\footnote{OECD (2020), The Tokenisation of Assets and Potential Implications for Financial Markets, OECD Blockchain Policy Series, accessible at \url{www.oecd.org/finance/The-Tokenisation-of-Assets-and-Potential-Implications-for-Financial-Markets.htm}.} Such stabilisation tools can consist of collateral held by the offerer/issuer, so that the stablecoin holder can redeem them at any time. The most well-known stablecoin is Libra (now: Diem) by Facebook.

- **Utility tokens** are tokens which provide access to a specific application or service. Among them we find Siacoin, a token which allows its holders to buy file storage space offered by other parties to the Sia network.

- **Asset tokens or digital securities** are a digital representation of assets such as participations in companies or a claim on dividends or interest payments (e.g. investment tokens).

\section{2.3 The Impact of Crypto-Assets on Financial Markets}


- it can improve the operational efficiency of financial markets by enabling transfers of value without the need for a trusted centralised intermediary ("disintermediation"); this goes true especially for payment tokens, e.g. stablecoins such as Libra/Diem;

- it can improve liquidity and the availability of capital because it allows for investment in fractions of assets, thus lowering the minimum investment threshold; this goes true especially for investment tokens with profit-rights attached, e.g. cryptographic stocks issued by businesses;
• it may render transactions instantaneous through the use of DLT infrastructure allowing to cut on transaction costs as well as clearing and settlement costs; this applies i.a. to utility tokens, which enable access to a product or service, e.g. to computing power;
• It may improve transparency as all network members have a full copy of the distributed ledger. This also entails that DLT systems are „automatically auditable“.

At the same time, tokenisation can give rise to issues of consumer protection, privacy, market integrity, cyber security and operational resilience. Crypto-assets in particular can be a useful tool for money laundering, terrorism financing and tax evasion.

3 The Regulation on Markets in Crypto-Assets (MiCA)

3.1 Background

There currently is no tailor-made regulatory framework for crypto-assets on the EU-level. A great deal of legal uncertainty prevails as to whether and to which extent existing EU-financial regulation applies to crypto-assets and related service providers (see cepInput). This stifles innovation and negatively affects consumer and investor protection. At the same time, a number of Member States such as France, Germany and Malta have introduced national regulations of the phenomenon. This may produce inconsistent approaches throughout the internal market.

Also, existing regulatory gaps could leave significant public interests exposed to threats. In December 2019, the Council and the Commission issued a joint statement on stablecoins, in which they expressed their concern that stablecoins with a global relevance may pose risks to monetary policy, the safety of payment systems, financial stability, and competition. As a consequence, the two institutions emphasised that „no global stablecoin arrangement should begin operation in the EU until the legal, regulatory and oversight challenges and risks have been adequately identified and addressed“. The MiCA is meant to do that.

3.2 Aim, Scope and Definitions

The MiCA proposal aims at providing legal certainty for issuers and service providers of crypto-assets. It applies only to issuers of crypto-assets that do not qualify as financial instruments under MiFID. The Regulation:

• defines three categories, i.e.
  – asset-referenced tokens (ART), which refer to the value of several fiat currencies that are

14 Id., p. 16.
18 Council of the EU, PRESS RELEASE, JOINT STATEMENT BY THE COUNCIL AND THE COMMISSION ON “STABLECOINS”, 5 December 2019, point 2.
19 Id.
legal tender (e.g. Euro and US-Dollar), or to one or several commodities (e.g. gold, oil), or to one or several crypto-assets (e.g. Bitcoin, Ethereum) or to a combination of such assets; most ART are stablecoins;
- e-money tokens (EMT), which refer to one fiat currency that is legal tender (e.g. Euro or the US-Dollar); most EMT are stablecoins;
- a catch-all category called "crypto-assets", encompassing any crypto-asset that is neither an ART nor an EMT; often these are utility tokens or asset tokens.

- sets obligations for issuers, depending on the category of asset issued;
- sets obligations for providers of crypto-asset services;
- establishes rules on the supervision of crypto-asset issuers and service providers; and
- introduces a market abuse regime for crypto-assets.

Below, we deal with the regulation of the issuance of those “crypto-assets” falling into the catch-all category. We will also cover (in chapter 3.4) the regulation of crypto-asset service providers because it has a de facto impact on the activity of issuers.

### 3.3 Issuance of Crypto-Assets

No issuer of crypto-assets, other than asset-referenced tokens (ARTs) or e-money tokens (EMTs), shall, in the Union, offer such crypto-assets to the public, or seek an admission of such crypto-assets to trading on a trading platform for crypto-assets, unless such issuer:

- is a legal entity;
- has drafted a crypto-asset white paper which faithfully describes, i.a., the issuer, the issuer’s projects and the rights and obligations attached to the crypto-asset. The white paper must be notified to the competent authority of the issuer’s home Member State and published;
- complies with consumer protection obligations, i.e.
  - to act honestly, fairly and professionally;
  - to communicate with the holders of crypto-assets in a fair, clear and not misleading manner;
  - to prevent, identify, manage and disclose conflicts of interest;
  - to comply with EU standards regarding their systems and access security;
  - to act in the best interests of the holders of the crypto-assets and to treat them equally and
  - to ensure that marketing communications is clearly identifiable as such, fair, clear and non misleading.

After the publication of its crypto-asset white paper, the issuer may offer its crypto-asset anywhere in the EU ("EU-Passport").

The obligation to notify a white paper does not apply when the crypto-asset is automatically created through mining as a reward for the maintenance of the DLT or the validation of transactions. The same goes when the crypto-asset is offered to fewer than 150 natural or legal persons, or to qualified investors only. Also, these above provisions do not apply to the issuers of crypto-assets which were offered to the public or admitted to trading on a trading platform for crypto-assets before the date of

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21 Article 4 para. 1 MiCA Proposal.
22 Therefore, it can be inferred that the white paper does not need a prior approval of the competent authority before its publication.
23 Article 6 MiCA Proposal.
24 Article 10 pra. 1 MiCA Proposal.
entry into force.

3.4 Crypto-Asset Service Providers

Crypto-asset services – meaning services offered in respect to any category of crypto-assets - include:

- Custody (i.e. safekeeping, on behalf of third parties, of crypto-assets or of the means of access to crypto-assets, e.g. private cryptographic keys;
- Operation of a trading platform for crypto-assets;
- Exchange of crypto-assets to fiat currency or vice versa;
- Execution of orders;
- Placing of crypto-assets (i.e. the marketing to specified purchasers of crypto-assets that are not admitted to trading on a trading platform for crypto-assets);
- Reception/transmission of orders; and
- Advice on crypto-assets.

3.4.1 Authorisation Regime

Crypto-asset services shall only be provided by legal persons

- having a registered office in a Member State of the EU, and
- authorised as crypto-asset service providers by the National Competent Authority of the Member State where they have the registered office.

Banks and investment firms do not need an additional authorisation as crypto-asset service provider. The same applies to third country providers that do not actively market their services to European users.

The authorisation grants the possibility to carry out the crypto-asset service specified therein anywhere in the EU (passporting principle).

ESMA shall establish and keep updated a register of all authorised crypto-asset service providers.

3.4.2 Obligations Laying on Crypto-Asset Service Providers

<table>
<thead>
<tr>
<th>Article 59</th>
<th>Fair clients’ treatment</th>
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<tr>
<td></td>
<td>• Obligation to act honestly, fairly and professionally;</td>
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<td>• Obligation to act in the best interest of the client;</td>
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<td>• Obligation to communicate in a fair, clear and not misleading manner; and</td>
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<td>• Obligation to disclose the risks associated with the purchase of crypto-assets and to make the provider’s pricing policy known.</td>
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<th>Article 60</th>
<th>Prudential requirements</th>
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25 Article 4(2) and Art. 123(1) MiCA Proposal.
26 Art. 53 MiCA Proposal.
27 Article 53 para. 1 MiCA Proposal.
28 Article 2(5) and (6) MiCA Proposal.
29 Recital 51 MiCA Proposal.
30 Article 53 para. 2 MiCA Proposal.
31 Article 53 para. 3 MiCA Proposal.
32 Article 57 MiCA Proposal.
Annex IV  The prudential requirement laying on crypto-asset service providers is to hold:
- own funds, i.e. Common Equity Tier 1 items; or
- an insurance policy which must cover specific risks (e.g. loss of documents or failure to prevent conflicts of interests) and all EU Member States where the services of the provider are offered.

Article 61  Organisational requirements
- Good repute and competence of members of the management body;
- Good repute and competence of those holding more than 20% share capital/voting rights;
- Skills, knowledge and expertise of personnel matching with the level of responsibility;
- Business continuity policy; and
- Internal control mechanisms and effective procedures for risk assessment.

Article 63  Safekeeping of clients’ crypto-assets and funds
This includes:
- When their business model requires holding clients’ funds, preventing the latter's use for the provider’s own account and placing them with a bank;
- When the provider offers payment services or relies on a third party for such services, the provider of payment services – whether the provider of crypto-asset services or a third party - must be authorised to do so.

Article 64  Complaint handling procedure
- Establishment of procedures for the prompt, fair and consistent handling of complaints;
- Free availability of the complaint procedure; and
- Guarantee of a timely and fair investigation, whose results are communicated to the client within a reasonable period of time.

Article 65  Prevention of conflicts of interest
Prevention, identification, management and disclosure of conflicts of interests between the provider and, i.a., its shareholders, members of its management body and clients.

Article 66  Outsourcing
Service providers remain responsible vis-à-vis their clients even in case of outsourcing. They must be able to evaluate how the outsourced service is performed by the third party and must have direct access to the necessary information regarding the outsourced service. The agreement between the crypto-asset service provider and the third party must
- Be written;
- Specify the rights and obligations pertaining to each; and
- Enable the crypto-asset service provider to trigger its termination.

3.5 Supervision

Compliance with MiCA rules is ensured by the national authorities, which are designated by Member States as competent supervisors.\(^{33}\) Supervision of the issuers of crypto-assets from third countries, that do not have an establishment in the EU, falls to the authorities of the Member States in which the crypto-assets are first offered or admitted to a trading platform for crypto-assets.\(^{34}\)

While the Member States are free to identify the competent authority/ies they find most suitable to lead supervision under MiCA, such authority/ies must dispose of a specific list of investigatory and supervisory powers (e.g. power to mandate the disclosure of information and documents, to suspend or interrupt the offer of crypto-assets or the provision of crypto-asset services, to make infringements public)\(^{35}\) as well as the ability to impose specific sanctions or administrative measures\(^{36}\), whose severity depends upon a list of criteria established by MiCA.\(^{37}\)

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\(^{33}\) Article 81 MiCA Proposal.

\(^{34}\) Art. 3 (1) No. (22) (c) MiCA Proposal.

\(^{35}\) Article 82 MiCA Proposal.

\(^{36}\) Article 92 MiCA Proposal.
When the national authority of the home Member State (i.e. the competent authority) remains inactive vis-à-vis a request for action by a national authority of a host Member State and the latter adopts precautionary measures to protect consumers, each of them can bring its disagreement with the other’s approach to the attention of ESMA. In such cases, ESMA intervenes pursuant to Art. 19 ESMA Regulation, meaning that, in case of a persistent lack of agreement between the national authorities, ESMA can directly decide upon the contentious matter and, in case of non-compliance of any of the national authorities with its decision, ESMA can adopt a decision directly addressed to the relevant market players. Such decision sidesteps any decision taken by any national authority.

4 The MiCA Proposal: A Few Considerations

4.1 What is the Impact of MiCA on Crypto-Assets Without an Issuer?

According to MiCA, crypto-assets that are neither ARTs nor EMTs can only be issued – i.e. offered to the public or made the object of an application for admission to trading when the issuer is a legal entity. The requirement that the issuer must be a legal entity is meant to ensure that all crypto-assets are properly monitored and supervised by the competent authorities. In fact, supervision is toothless in the absence of an entity which can be concretely subject to scrutiny, held liable for breaches of the regulatory framework and whom supervisory decisions can be addressed to. In this perspective, effective supervision should not be considered an end but a necessary condition for MiCA to deliver its objectives, including “a high level of consumer protection”.

MiCA seems to implicitly render illegitimate the offer to third parties of those crypto-assets, which are automatically offered by decentralised DLT networks - e.g. the blockchain – (e.g. Bitcoin). In fact, in those cases it is impossible to identify an issuing entity and the above concerns for the effectiveness of supervision could well materialise.

Given the relevance of the cryptocurrencies market, it would be appropriate to amend MiCA to explicitly address the phenomenon of cryptocurrencies issued by decentralised DLT networks. This would make the implications of MiCA for such segment of the market clearer and make it more likely for MiCA to achieve its main objective, i.e. legal certainty. In any case, the legal entity requirement – along with other requirements set by MiCA for issuers of crypto-assets – is not applicable to issuers of crypto-assets, which were already offered/admitted to trading in the EU before the entry into force of the regulation. Hence, limitations arising from the lack of a legal entity do not apply e.g. to Bitcoin.

37 Article 93 MiCA Proposal.
38 Article 89 para. 3 MiCA Proposal.
40 Article 3 para. 1 n. 6 MiCA Proposal.
41 Article 4 para. 1 MiCA Proposal.
42 Considerandum 13 of MiCA Proposal.
43 Considerandum n. 5 MiCA Proposal.
44 Article 123 para. 1 MiCA Proposal.
4.2 Is Supervision Over Crypto-Assets Issuers Effective Under MiCA?

The supervisory regime under MiCA raises a few doubts as to its effectiveness.

First, notwithstanding the requirement for the issuers of non-EMT and non-ART crypto-assets to be legal entities, MiCA does not also require such legal entities to be established in the EU. The fact that an issuer based in a third country can be concretely monitored by a national authority of a Member State is contestable. Also, the enforcement of possible measures addressed to it by such national supervisor seems highly problematic, given that such measures would not be automatically enforceable according to the legal order of the third country, where the issuer is located.

Secondly, the evolution of the market in all categories of crypto-assets should be accompanied by a corresponding evolution of supervisors’ expertise and resources in the area of fintech. While MiCA is silent in this regard, it would have been advisable to include in it minimum standards as to the skills and tools that a national supervisory authority must possess to be legitimately designated as competent authority under MiCA. In this regard, it should be underlined that supervisors lacking such skills and tools could seriously undermine the consumer protection envisaged by MiCA, which is as high as the one ensured by the least equipped national authority.

4.3 Simplicity vs. Proportionality: Is The Whitepaper Obligation Appropriate for Non-Financial Utility Tokens?

Pursuant to the MiCA proposal, all non-EMT and non-ART crypto-assets are subject to the same rules. This residual “catch all”-category of crypto assets encompasses a wide variety of assets, some of which have no direct relationship to financial markets. This can be the case for those utility tokens that grant rights to the use of a product or service or serve as vouchers.

It is contestable whether subjecting issuers of such utility tokens to the obligation to submit a whitepaper - a requirement usually designed for issuers of securities - is appropriate, given the burdensome disclosure requirements it entails. However, this must be understood as a side-effect of the lack of a more detailed taxonomy of crypto-assets under MiCA. Although this lack of detail makes it simple for market operators to identify the category they belong to - and, accordingly, the regulatory regime applicable to them, it risks subjecting some market players to disproportionate requirements.

4.4 Lack of a Complementary Harmonisation of Private Law: Is Action Needed?

The tokenisation of an asset does not exempt such asset from the private law rules that govern, e.g., its legal qualification or the transfer of property over it. Different rules of private law could either cover a crypto-asset or be inapplicable to it, depending on its characteristics.

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45 "The overall approach to supervision should adapt to the digitisation of the activities of supervised entities. A finance becomes increasingly digitised, financial supervision needs to keep up" (Broeders D., Prenio J., Innovative technology in financial supervision (suptech) – the experience of early users, FSI Insights on policy implementation No 9, July 2018, p. 2).

On top of this, Member States have different systems of private law, so that the relevant private law rules might look very different depending on the relevant legal order.

This could create a situation of substantial legal uncertainty. For example, cross-border transactions involving crypto-assets might give rise to disputes as to who owns the underlying asset. Such disputes could have different outcomes across the internal market because the enforceability of the transaction would depend upon which national private law rules apply.

The above problem can be mitigated by harmonising the relevant private law rules. A second best-option would be to establish a consistent conflict-of-laws regime, which would allow the parties to a transaction involving crypto-assets to know which national private law is applicable.47

While the problem of an inconsistent approach by different private law systems does not undermine the ability of MiCA to produce significant improvements in terms of legal certainty, a complementary regime of the kind described above is needed.

5 Conclusions

While the Commission’s efforts to bring about legal certainty in the EU crypto-assets market are to be welcomed, the proposed Regulation deserves a few adjustments for that objective to be met. Notably, changes are required to the provisions regarding the regime of non-ART and non-EMT crypto-assets, which should unambiguously state whether, according to MiCA, the issuance of cryptocurrencies through permissionless DLT networks is legitimate.

Also, the Commission should consider (1) adding minimum requirements as to the skills and tools that a national supervisory authority must possess to be legitimately designated as competent authority under MiCA and (2) harmonising the relevant private law rules (or, as a second best solution, establishing a conflict-of-laws regime).

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47 European System of Central Banks (ESCB) response to the European Commission’s public consultation on EU framework for markets in crypto-assets.
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